energy API

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Testimony of
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Opposition to HB-6518, Gasoline Marketing
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The Connecticut Petroleum Council---representing major oil companies, terminal operators and others---submits the following comments in opposition to HB-6518, the omnibus gasoline marketing bill. The bill contains a gasoline zone pricing ban applicable to wholesalers-only, a price-control provision tying different wholesale prices to one another, and anti-price gouging language largely applicable to gasoline. We strongly recommend that consumers---rather than the General Assembly---be allowed to pick the winners and losers among service stations, and that the zone pricing ban and price-control provisions be deleted in their entirety from the bill.

Gasoline Zone Pricing Ban (Lines 1-7)

The proposed gasoline zone pricing ban prohibits wholesalers from varying their prices to retailers because of competition, and therefore leads to inflexible, anti-competitive results. The bill clearly prevents intra-brand competition, an action which the Federal Trade Commission (FTC) has strongly warned against doing. The FTC, numerous studies, and an in-state study commissioned by API and compiled using hard pricing data by professors at Quinnipiac University show the same types of results: that, overall, zone pricing reduces prices, or that banning it leads to higher prices. In a letter dated May 2, 2007, the FTC explicitly warned the Connecticut General Law Committee not to pass a gasoline zone pricing ban because it was not in the best interest of consumers. We find no evidence anywhere that a ban reduces prices.

Under this proposal, a wholesaler selling gasoline cannot lower its price of gas to a retailer who has extreme competition (thereby benefiting consumers) without lowering its prices to other retailers not facing that situation. If a wholesaler wants to sell at cost (no profit) at one location to meet a competitor, he can no longer do so without putting his entire chain of stations at risk. Faced with losing his whole chain or just one station, he may elect not to meet the competitor's price and risk losing that station, thereby reducing competition in the area. Overall, this leads to fewer stations and less competition, thereby hurting consumers.

Conversely, when a wholesaler increases its price to one station, he is compelled to increase it statewide, thereby forcing up prices to a wide range of consumers who otherwise might not face an increase. Competition for gasoline sales is local, not statewide, but a rule preventing increases and/or decreases at only certain stations forces prices statewide to go up or down in a uniform manner, thereby depriving customers of the price wars that exist in many parts of the state. Sheraton and Hilton vary their prices by city based on competition in those cities, not on a statewide average, and Super Stop & Shop and CVS do the same for food and drugs, because price competition is local in nature.

Price Control Provision (Lines 7-19)

As written, this bill clearly favors lessee-dealers over owner-dealers, distributors, refiners and their customers. In our view, the marketplace should determine winners and losers, not the General Assembly. This section allows all gasoline retailers to buy gas from their wholesaler at the same price, irrespective of differing levels of costs, investments and risk. Dealers who buy gas directly from a large wholesaler via a dealer tank wagon (DTW) price sometimes complain they pay more than others for gas, but they choose to accept a business model that includes substantially less risk for themselves, and transfer the risk to the wholesaler, who may reflect it in the DTW.

Example #1: A lessee-dealer in Stamford pays his wholesaler rent and the DTW cost of gas. The wholesaler owns the land, the station, the undergrounds tanks and the pumps, valued at $2 million. The wholesaler sets the price (DTW) to the station, while the retailer sets the pump price. The dealer pays some fees to the wholesaler to get started (only a small fraction of the market value of the station itself), and signs a franchise contract to abide by the terms set forth by the wholesaler. In this model, the dealer has only a small investment (unlike McDonald's or Burger King), and shifts the most severe risks to the wholesaler, who absorbs directly the following business costs instead of the dealer:

- Use of the station---wholesaler pays for the station upfront, not the dealer. This keeps barriers-to--entry for the dealer low, and encourages more dealers to enter the business, thereby enhancing competition. Dealer does not need $2 million to enter the business.
- Marketing costs—cost of advertising, promotions (TV, radio, print, materials) and marketing support, especially if there is severe competition down the street.
- Some financial risk---dealer may not survive due to competition or errors in the business plan.
- Environmental risk---cost of cleaning-up underground storage tank leaks.
- Damage to the station & major fixtures---(earthquakes, fires, floods, mudslides, damage to pumps from traffic accidents.)
- Fuel tax returns and payments to IRS & state DOR---cost of lawyers and accountants.
- Inventory---assuring there is enough inventory in storage (i.e. New Haven, Bridgeport) to supply the station, even during catastrophic events such as hurricanes. Stations supplied via DTW rarely, if ever, run dry. Unlike a fuel oil dealer, a service station dealer does not pay to hedge fuel.
- Volatility protection---DTW prices historically have been among the least volatile when prices spike. Some major oil companies kept their dealer prices steady immediately after Hurricanes Katrina in 2005, thereby steadying the market.
- Transportation cost of delivering fuel to the station.

When the lessee dealer chooses to retire or leave the business, he may sell his right-to-operate to another dealer for so-called "Blue Sky Value", which can range well into six-figures.

Example #2: An owner-dealer (dealer who owns his own station and land) pays his mortgage to the bank and pays his wholesaler (major oil company or distributor) for gas. He needs $2 million upfront to get started or needs to get a mortgage in order to buy the station. Unlike a lessee-dealer, he chooses to accept much more risk. He may buy from a major oil company or a smaller wholesaler.

Unlike the lessee-dealer in Example #1, the owner-dealer accepts the risk for the big-ticket items: owning the station including the full cost of the station itself, all environmental risk, and damage to the station & its fixtures. It makes sense he might be able to buy gas for less, because the wholesaler is NOT accepting the numerous risks in Example #2, but is accepting them in Example #1. Yet some dealer-owners still choose to accept a DTW in order to do business directly with a major oil company. Both models exist, and should be allowed to continue, with the marketplace determining what the price difference should be.

Example #3: A distributor (or middleman) buys at the Rack Price from a major supplier, and then re-sells it to a dealer (Example #2 above), or builds his/her own stations, supplies them directly, and sells gas to the public. In this example, the middleman is a re-seller (similar to a food distributor), and acts like a major oil company. If he builds his own stations, he absorbs all the risk outlined in Example #1. The rack price is the price at which gasoline is sold by supplier to distributors, and includes nothing but the gasoline. Other costs are not included. It is up to the distributor to market the gas. Rack prices are much more volatile than DTW prices, and normally draw significant attention during hurricanes.

Because they are re-sellers, distributors who buy at the "Rack Price" accept far more risk and face many more investment costs than lessee-dealers who buy at DTW, or dealer-owners.

Anti-Price Gouging (Lines 88-145)

No price-gouging was found and no charges were brought against refiners after a series of civil investigative demands and subpoenas were issued to refiners in Connecticut: 1997---gasoline price spike; 2003---oil price increases; and 2005---Hurricanes Katrina, Wilma and Rita. In 2008, there were simultaneous subpoenas issued by the Attorney-General and the Office of Consumer Protection after Hurricane Ike, and again, no wrong-doing was identified against refiners. Based on that track-record, we find no reason for this portion of the bill.

As you know, the U.S. is not self-sufficient in crude oil or gasoline, and must rely on imports for most of its supply. It cannot afford to ignore market forces outside of its borders by creating an artificial pricing regime within. If this bill passes, gasoline sellers during periods of "market stress" may choose to sell their fuel to markets other than Connecticut, thereby placing the state's gasoline supplies at risk. As a state at the end of the fuel supply chain, we should adopt policies that encourage---rather than discourage---fuel suppliers to sell here. The proposed anti-price gouging rule found in Section 3 is vague in two key sections, and creates a series of major compliance traps for petroleum sellers who sell in good faith:

Key areas of concern:

- Line 93---We recommend all language after the word "circumstance" should be deleted, and that the following words be added after the word "circumstance": "which cause the Governor to issue a disaster emergency declaration, pursuant to chapter 517 of the general statutes."

Rationale: If left unchanged, the language says that an abnormal market disruption can occur for any of the events listed, OR a disaster emergency regulation. Some of those events are occurring today (civil disorder in Nigeria). There needs to be a clear gubernatorial declaration for the law to become operative.

- Lines 102-105---We recommend this language be deleted, and that the new language read: "No seller during any period of abnormal market disruption shall sell or offer to sell motor gasoline for an amount that represents an unconscionably excessive price." The deletion of the "imminent abnormal market disruption is reasonably anticipated" language should also be deleted from lines 113-114, and 126-127.

Rationale: After intense discussion, no one could agree as to when "an imminent abnormal market disruption is reasonably anticipated." At what point does a developing hurricane meet this criteria? Or an attempted coup in Venezuela? A lesser standard of "imminent abnormal market disruption is reasonably anticipated" is extremely vague, and does not rise to the level of an "abnormal market disruption." Power to declare an emergency should rest solely with the governor, and should not be split between the Governor and Attorney-General

- Lines 141-143---We recommend the fines be reduced to $1,000 per violation, and that the double damages provision be deleted.

Rationale: Each and every sale could be a violation, thus, the fines can elevate very quickly. In the absence of bad intent or intentional wrongdoing, there is no reason for double damages.